DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 2, 2000

Accounting Policy Memorandum – OAIC 00-02

MEMORANDUM FOR BUREAU CHIEF FINANCIAL OFFICERS
DEPUTY CHIEF FINANCIAL OFFICERS

FROM: James R. Lingebach (signed)
Acting Deputy Chief Financial Officer

SUBJECT: Internal Use Software

The Office of the Deputy Chief Financial Officer is issuing this Accounting Policy Memorandum to be used in assistance with Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Consistent with Treasury Directive 32-01, *Accounting Principles and Standards*, this memorandum provides additional implementation guidance to amend the Department's accounting principles and standards.

Attachment

In accordance with Treasury Directive 32-01, *Accounting Principles and Standards*, this memorandum provides additional guidance on accounting for the costs of computer software developed or obtained for internal use. Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment* should also be referenced. Treasury Directive 32-01 will require the following:

Implementation Date

1. The Department is recommending that October 1, 2000 be the implementation date for SFFAS No. 10. All cost, whether direct or indirect prior to October 1, 2000 should be expensed. Exceptions may be granted if a bureau believes that the Department's recommendation may misrepresent or distort an individual bureau's financial reporting disclosure. In that case, the bureau, along with their auditor, will need to present to the Department and the Inspector General their plan of action for capitalizing costs for their financial statements and how it will affect the Department's financial statements.

2. Procedures for estimating costs to be capitalized retroactively in the event of an exception should follow the methods used in SFFAS No. 6. It is the Department's intention to consistently apply policy related to the implementation date of SFFAS No.10, to all potential internal use software assets. Estimation methodologies should be documented.

3. SFFAS No. 10 requires the capitalization of the cost of internal use software whether its is commercial "off-the-shelf" (COTS), contractor developed, or internally developed by employees.

Threshold

4. The Department's internal use software capitalization threshold will remain the same as our current capitalization threshold (memorandum dated September 28, 1999 from the DCFO to bureau CFOs). Individual assets of $25,000 - $50,000 and Bulk Purchases of $250,000 - $500,000.

Trigger Point

5. The trigger point, when management determines when to start capitalizing, begins when 1) management authorizes and commits to a computer software project and provides funding, and 2) believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function with an estimated service life of two years or more. SFFAS No. 10 states that for internally developed software, capitalized costs should include the full cost (direct and indirect cost) incurred during the software development stage. It also states that for each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing.

Improvements - Useful Life

6. Improvement costs should be capitalized only if (1) they meet the Department's established capitalization threshold and (2) the improvements extend the functionality of the software. Otherwise, if the improvements are below the threshold, or are above the threshold but only extend the useful life of the software, the costs should be expensed. If improvement costs extend the life of the asset, the net book value should be re-amortized over the newly revised estimate life of the asset.

7. Implementation of SFFAS No. 10 should not change existing budgetary practice. Therefore, it is not intended that existing budgets or line items be rebaselined for the purpose of implementing SFFAS No. 10. Costs for software development activities under the provisions of SFFAS No. 10 should be collected, regardless of their funding source, and included in the full cost of the software asset.

8. Estimated costs are acceptable under certain conditions, for example, when direct determination is not possible, and should be well documented. All concerns about direct/indirect costs and how to apply them should be implemented consistent with SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*.

9. Because it is typical to have multiple uses of software on one hardware system, the useful life of software and hardware should be based independently of each other.

Licenses/Leases/Revenue Recognition

10. Lease accounting concepts should be applied along with the Department's existing policy for capitalization thresholds and for bulk purchases of licenses. Immaterial costs can be expensed, but the bureaus should consider whether period costs would be distorted by expensing the license. As good management practice, the cost of the software versus maintenance costs should be defined within the license agreement.

11. In order to capitalize a license agreement that may include maintenance, i.e., technical support, as well as software upgrades, bureaus need to have license agreements broken out to specifically identify the various costs throughout the license lifecycle, e.g., initial license (capitalizing if it meets the threshold), maintenance, enhancement, etc.

12. When purchasing individual packages of typical desktop software, many bureaus will acquire either a site or enterprise license, which allows unlimited use of a single package at a site or across the enterprise, or bureaus will buy, with a single purchase, a sufficient number of individual licenses to cover the use of a large percentage of the site or enterprise population (frequently referred to as a "seat license"). These purchases should all be considered as integrated infrastructure purchases and the costs capitalized, if other capitalization criteria are met. This should apply even to software that can be used independently, such as word processors or spreadsheet software.

13. License fees received as exchange for transferring software to another agency or outside party should be treated as exchange revenue. The receipt of such fees does not alter the normal capitalization amounts or process for such software. If a bureau were in the "business" of developing software, usually in a Working Capital Fund environment, revenue from sales or licensing would normally be recorded in the Working Capital Fund. In the rare instance that a bureau should engage to develop software for another agency, guidance in Financial Accounting Standards Board (FASB) No. 86 should apply.

Full Cost/Work-In-Progress/Cost Allocation

14. In order to capture the full cost of a software project that is performed for a support organization at the time the asset is capitalized, SFFAS No. 10 is consistent with SFFAS No. 4. The capitalized cost of internally developed software includes the full costs incurred during the development stage, within the meaning of SFFAS No. 4, paragraphs 91-92. SFFAS No. 4 requires agencies to account for the "full cost" of their products and services in general purpose financial reports. In most circumstances, the full costs of intermediate cost objects, including software projects, must also be measured in order to derive the full costs of an agency's output. However, not all costs are assignable to goods and services. Some costs should be recognized as period expenses rather than the costs of goods and services (output costs); for example, other post employment benefits, reorganization costs, and acquisition costs of "heritage assets." The bureau will choose the cost accounting methodology to employ to meet the requirement. SFFAS No. 4 presents a discussion of activity-based costing, process costing, job order costing, and standard costing. Any of these methodologies or a combination of them would capture the developmental costs of internal use software as work-in-progress (WIP). Any WIP account balance at the end of the period would be presented as an asset on the balance sheet. The WIP account balance would be closed and a software asset account opened after the users accept the software, i.e., after successful testing. Amortization would begin thereafter. In instances where the software is developed in a general and administrative function, two scenarios are possible-- either the general and administrative function is an individual responsibility center or it is part of a larger responsibility center. In either case, the bureau will determine the direct and indirect costs of constructing the software. The amortized costs of the software asset in the general and administrative function would be charged to other activities, as part of the overhead rate.

15. All bureaus will not necessarily use the same overhead method. SFFAS No. 4 discusses several methods for tracing, assigning, or allocating costs to objects. Overhead methodologies among Treasury bureaus will be consistent to the extent that they conform to the framework in SFFAS No. 4. SFFAS No. 4 and other accounting principles require individual reporting bureaus to be consistent in the application of cost methodologies and other accounting principles. Each bureau will apply consistent overhead methodologies to its own operations where feasible and appropriate to the operating environment. Each bureau will determine how to allocate their costs. The methodology selected needs to be well documented and applied with consistency. With respect to auditing concerns, bureaus should consult the above standard and OMB Bulletin No. 98-08, "*Auditing*

Requirements for Federal Financial Statements." Bulletin No. 98-08 describes the process auditors are expected to follow when making a determination as to whether the bureau is following the Federal Financial Management Improvement Act of 1996 (FFMIA) requirement to employ FASAB standards, federal systems requirements, and the Standard General Ledger at the transaction level. Bulletin 98-08 refers the auditor to OMB Circular A-127, *Financial Management Systems*, FFMSR-8 (Feb. 1998). Chapter III of FFMSR-8 provides the functional requirements for systems supporting managerial cost accounting, including system administration, data capture, cost assignment, cost classification, and cost monitoring.

16. SFFAS No. 10 shall apply to user-developed applications, including web pages and spreadsheets. Any such project should be assessed from both financial and technical perspectives to determine whether the resulting product is to be a capital asset. The assessment should consider the type of software involved, the related life cycle phase, and the intended function of the software product.

17. As an implementation strategy, systems workarounds, including accounting and others, are acceptable as long as they are well documented and are limited in scope. Permanent changes to systems so that project costs are properly and timely captured, tracked, and amortized should be in place as soon as possible in order to not adversely impact the long-term implementation and results derived from SFFAS No. 10.